

**Initial Statement of Reasons**  
**Adoption of Proposed Amendments to**  
**California Code of Regulations, Title 18, Section 1685.5,**  
***Calculation of Estimated Use Tax - Use Tax Table***

**SPECIFIC PURPOSE AND NECESSITY**

Current Law

Under Revenue and Taxation Code (RTC) sections 6202 and 6453, consumers are primarily liable for reporting and paying use tax imposed on the storage, use, or other consumption of tangible personal property in this state. However, under RTC sections 6203, 6226, and 6453, specified retailers are required to register with the State Board of Equalization (Board), collect use tax from their California customers, and report and pay the use tax to the state. Therefore, under California Code of Regulations, title 18, section (Regulation) 1685, *Payment of Tax by Purchasers*, consumers are required to report and pay their own use taxes to the state when they purchase tangible personal property for storage, use, or other consumption in this state from unregistered retailers that do not collect California use tax.

Prior to 2010, consumers could only report and pay their use taxes to the Board. However, RTC section 6452.1 was enacted in 2010 to make it more convenient for consumers to comply with their use tax obligations by permitting consumers to make an irrevocable election to report “qualified use tax” on an “acceptable [income] tax return” filed with the Franchise Tax Board (FTB). RTC section 6452.1, subdivision (d)(2), as enacted by Statutes 2010, chapter 721, defined the term “qualified use tax” to mean a taxpayer’s actual unpaid use tax liability after applying the state use taxes imposed under the Sales and Use Tax Law (RTC § 6001 et seq.) and article XIII of the California Constitution, and the local and district use taxes imposed in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC § 7200 et seq.) or in accordance with the Transactions and Use Tax Law (RTC § 7251 et seq.) to the taxpayer’s purchases of tangible personal property subject to use tax.

Senate Bill No. (SB) 86 (Stats. 2011, ch. 14) amended RTC section 6452.1 to make it more convenient for taxpayers to comply with their use tax obligations by giving taxpayers the option to report their “estimated use tax liabilities,” based upon their adjusted gross incomes (AGIs) for income tax purposes, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table, on their income tax returns, instead of calculating and reporting their actual unpaid use tax liabilities (as described above). In addition, RTC section 6452.1, subdivision (d)(2)(A)(i)(II), as amended by SB 86, requires the Board to “annually calculate the estimated amount of use tax due according to a person’s adjusted gross income and by

July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table” for inclusion in the instructions to the FTB’s returns and use by eligible taxpayers.

The Board adopted Regulation 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*, on July 26, 2011, to prescribe the specific use tax table that taxpayers could use to estimate their calendar-year 2011 use taxes based upon their AGIs, prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person’s AGI for calendar-year 2012 and subsequent years, and prescribe the format of the use tax tables the Board would be required to make available to the FTB for calendar-year 2012 and subsequent years. After discussing Regulation 1685.5 with interested parties, the Board adopted amendments to Regulation 1685.5 on March 20, 2012, to update the manner in which the Board annually calculates the estimated amount of use tax due according to a person’s AGI and makes such amounts available to the FTB in the form of a use tax table for calendar year 2012 and subsequent years.

The Notice of Action for the 2012 amendments explained that:

The proposed [2012] amendments to Regulation 1685.5, subdivision (b)(2), will require that the Board multiply the percentage of income spent on taxable purchases during the preceding year by 0.37, which represents the estimated percentage of California consumers’ total purchases of tangible personal property for use in California from all out-of-state retailers that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers. AB 155 (Stats. 2011, ch. 313) expanded the use tax registration requirements so that they apply to some out-of-state retailers, including Internet retailers, that were previously not required to register with the Board to collect and remit use tax on their sales of tangible personal property to California customers. However, section 6 of AB 155 provides that the new registration requirements will not be operative until either September 15, 2012, or January 1, 2013, and the Board is currently unable to determine whether the new registration requirements will reduce the percentage of California consumers’ total purchases of tangible personal property for use in California from all out-of-state retailers that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers during 2012 or in subsequent years, and, if so, the extent of such reduction. Therefore, the Board is not proposing to amend Regulation 1685.5 to account for the new registration requirements imposed by AB 155 at this time. However, the Board is continuing to monitor the implementation of AB 155 and considering whether to propose sufficiently related changes to the original text of the proposed amendments to Regulation 1685.5 to account for the enactment of AB 155 or other events that may change the percentage of taxable purchases that California consumers make from unregistered out-of-state retailers during 2012 or subsequent years.

However, the Board did not make sufficiently related changes to the text of the 2012 amendments to Regulation 1685.5 to account for the enactment of AB 155 because the Board could not determine when AB 155's expanded use tax registration requirements would be operative and could not adequately estimate the effect of the expanded use tax registration requirements when the Board adopted the 2012 amendments. Instead, the Board continued to monitor the implementation of AB 155 and consider whether to propose amendments to Regulation 1685.5 to account for the enactment of AB 155 and the expanded use tax registration requirements effect on the percentage of taxable purchases that California consumers make from unregistered out-of-state retailers during calendar-year 2013 and subsequent years.

#### Specific Purpose, Necessity, and Benefits of the Proposed Amendments

The expanded registration requirements (discussed above) became operative on September 15, 2012, in accordance with section 6, subdivision (b)(2), of AB 155. The Board did see an increase in the number of out-of-state retailers registered to collect California use tax around that time, and Board staff was subsequently able to determine that those registration activities, including the registration of some retailers that make substantial sales to California consumers, indicate that there will be an overall decrease in the percentage of taxable purchases California consumers make from unregistered out-of-state retailers during calendar-year 2013, and in subsequent years. In addition, Board staff was able to:

- Calculate adjusted total 2011 United States electronic commerce sales;
- Determine that 86.9 percent of those sales were made by the top 500 Internet retailers and 13.1 percent of those sales were made by other Internet retailers;
- Estimate that 14.4 percent of the top 500 Internet retailers and 78 percent of the other Internet retailers were not registered with the Board to collect use tax after the operative date of AB 155; and
- Arrive at a weighted average percentage of sales made by unregistered Internet retailers of 22.7 percent  $((.869 \times .144) + (.131 \times .78))$ .

Therefore, staff prepared a memorandum dated January 4, 2013, which recommended that "the Board amend Regulation 1685.5, subdivision (b)(2), to change the estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers from 37 percent to 23 percent to account for the new use tax registration requirements imposed by AB 155 and recent registration activities." And, Board staff submitted the memorandum to the Board Members for their consideration at the Board's January 15, 2013, Business Taxes Committee meeting.

During the January 15, 2013, meeting, Ms. Gina Rodriquez, Vice President of State Tax Policy for the California Taxpayers Association (CalTax), stated that CalTax supports the amendments to Regulation 1685.5 and the Board Members unanimously voted to propose their adoption. The Board determined that the amendments are reasonably necessary to address the problem of ensuring that the Board's future calculations of the estimated

amount of use tax due according to a person's AGI account for the expanded registration requirements imposed by AB 155 operative September 15, 2012, and the recent registration activity discussed above. The Board anticipates that the proposed amendments will promote fairness and generally encourage consumers to use the Board's use tax tables by ensuring that eligible consumers' estimated use tax liabilities are as accurate as possible.

The proposed amendments to Regulation 1685.5 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1685.5.

#### DOCUMENTS RELIED UPON

The Board relied upon the January 4, 2013, memorandum referred to above, the exhibit to the memorandum, which illustrated the proposed amendments to Regulation 1685.5, and the comments made during the Board's discussion of the memorandum during its January 15, 2013, Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1685.5 described above.

#### ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1685.5 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1685.5 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

#### INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(6) AND ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

Regulation 1685.5 only prescribes the manner in which the Board "shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table," as required by RTC section 6452.1. In

addition, Regulation 1685.5, subdivision (a)(2) provides that the Board's use tax tables "may not be used to estimate use tax liabilities for business purchases" and that consumers are not required to use the Board's use tax tables to estimate and report their use tax liabilities for nonbusiness purchases.

The proposed amendments to Regulation 1685.5 will improve the accuracy of the Board's calculations of the estimated amount of use tax due according to a person's AGI for calendar-year 2013 and subsequent years by accounting for the expanded use tax registration requirements imposed by AB 155 operative September 15, 2012, and a recent increase in the number of out-of-state retailers registered to collect California use tax, including the registration of some retailers that make substantial sales to California consumers. As such, the amendments merely reflect an increase in the percentage of use tax that will be collected by registered retailers and remitted to the Board and a decrease in the percentage of use tax that consumers will continue to be required to directly report and pay to the state, not a change in the total amount of use tax required to be paid by consumers.

Furthermore, Regulation 1685.5 does not regulate business, the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has determined that the adoption of the proposed amendments to Regulation 1685.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. The Board has also determined that the adoption of the proposed amendments to Regulation 1685.5 will not affect the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1685.5 will not have a significant adverse economic impact on business.

The proposed amendments may affect small business.